The CURE

Contract User's Resource for Excellence

The "CURE" is a quarterly newsletter of the State Controller's Office

Volume 4, Issue 3 **July 1, 1998**

News From The SCO

A State Controller's Office Update

by JOHN IVY, SCO

⇒ Phase II Waiver Request - A First

The State Controller's Office (SCO) has completed a review of the first Phase II Waiver request from an agency, which, if approved, will allow small dollar contracts to be processed without a formal legal review. The Department of Corrections applied for the request in support of their new Youth Offender Program where small dollar value contracts are necessary to provide services for inmates. Although only about 30 contracts are anticipated this fiscal year, the statewide program is expected to grow in the years to come and the Phase II Waiver will be used to expedite the additional contracts.

⇒ Peer Assessments

A peer assessment was recently completed at the Colorado Department of Public Health and Environment (CDPHE). The review team noted that the CDPHE was adequately performing its delegated duties and responsibilities under the Phase I Waiver program. This was the second peer assessment completed by the SCO this fiscal year. Plans are to conduct at least four peer assessments during FY 99. Any volunteers?

⇒ Contract Training

As of July 1, the SCO contract to provide Contract Management Training was completed and the responsibility to continue to provide Contract Management Training was given to the State Training Academy. The course will be incorporated into its training program, which is offered on a monthly basis, and listed in the *Stateline* Should you have questions concerning the dates of the training or need a Contract Management Course tailored for your specific agency, please contact Brad Mallon at (303) 866-4265. Brad will be the primary point of contact and instructor for all future contract training courses. (e-mail: **brad.mallon@state.co.us**)

Personal Services Annual Report Checklist

by Yvonne Anderson, SCO

Please note the three page attachment with this issue of the CURE. This attachment is a checklist for agencies to use when compiling the Personal Services Annual Report. If you have any questions, please contact Yvonne Anderson at (303)866-2862.

Central Approvers

NAME	PHONE #	FAX #
Privatization Program:		
Yvonne Anderson	(303) 866-2862	(303) 866-4090
Contract Approval (SCO):		
Phil Holtmann	(303) 866-3809	(303) 866-4090
Chris Trujillo	(303) 866-3820	(303) 866-4090
State Buildings:		
Michael Frieman	(303) 866-2874	(303) 866-7440
State Purchasing:		
Kay Kishline	(303) 866-6181	(303) 894-7444
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Limitation of Liability Clauses

by Richard Pennington, Department of Law

The contract "boilerplate" of many commercial companies limits their company's liability for defective performance or against claims by third parties, and shifts liability to their customers (e.g. the State) for certain defined types of claims. These paragraphs often are called different things: limitation of liability, disclaimer of warranties, limitation on damages, indemnification, and the like. Often they are not integrated in a single paragraph, but appear in various places in the agreement. A representative example of limitation of liability provisions in a software license might be:

1. Licensee will indemnify, hold harmless, and defend Licensor from and against all claims, lawsuits, damages, or liability, including attorneys fees, that arise or result from the use of Licensor's software.

2. LICENSOR DISCLAIMS ALL WARRANTIES, EITHER EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO THE WARRANTIES OF TITLE, NONINFRINGEMENT, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, WITH RESPECT TO THE SOFTWARE PRODUCTS AND RELATED USER MANUALS AND DOCUMENTATION DELIVERED BY LICENSOR TO THE LICENSEE.

3. In no event shall Licensor or its respective suppliers or affiliates be liable for any incidental, consequential, indirect, special or punitive damages (including without limitation, damages for loss of profits or revenues, business interruption, loss of business information, or other pecuniary loss) arising under or in connection with the use of products licensed hereunder, whether such damages arise in or are alleged to arise in tort, contract, or otherwise, and in any event the total liability for any damages payable in tort, contract, or otherwise shall be limited to the amount actually paid by Licensee to Licensor under this license.

Pages 6-27 to 6-28 of the *Colorado Contract Procedures and Management Manual* discuss the use of limitation of liability provisions in State contracts. That discussion is consistent with the June 24, 1996 joint State Purchasing Director/State Controller memorandum in Annex B of the *Colorado Contract Procedures and Management Manual*, that established policy for use of limitation of liability provisions in State purchase orders. Here are a few comments about problems with the above paragraphs:

1. The threshold problem with most of these clauses is understanding the terms. If the provisions always used the terms "contractor" and "State," it would be easier to recognize offending terms. However, often the vendor's boilerplate will be generic, and in the case of software vendors, often uses other terms such as "licensor" and "licensee." In a software licensing context, the vendor is the "licensor" and the State the "licensee." Consequently, paragraph 1 offends the prohibition on indemnification by the State and must be deleted from the contract. Unless there is statutory authority for indemnification, these provisions requiring the State to indemnify the contractor may be violations of Article 11, sec. 1, of the Colorado Constitution and are unauthorized waivers of governmental immunity.

2. Vendors commonly use warranty disclaimers to disclaim the implied warranties of merchantability (that a supply will pass without objection within the trade and is of average quality) and fitness for particular purpose (supply will meet the particular purpose communicated by the buyer to the seller). These implied warranties arise under the Uniform Commercial Code in "transactions in goods" and may be disclaimed. Page 10-61 of the *Colorado Contract Procedures and Management Manual* has a more lengthy discussion of these warranties.

Even though these clauses sometimes also disclaim express warranties, the disclaimers have not been construed to apply to specific specification/statement of work requirements in the contract. They probably do, however, limit any ability of a buyer to claim that representations were made in connection with the purchase that are "express warranties," where those representations are not in the written contract.

Continued from page 2 **"Limitation of Liability Clauses**

The disclaimer of warranties of title and infringement are more troubling, though. Especially in a software licensing agreement, the State would certainly want some assurance that the products being delivered did not infringe another company's patent or copyright. At the least, you would want to delete that part of the warranty disclaimer, making Special Provision #4 (indemnification of the State) operative if the State were sued by another company claiming infringement.

Otherwise, the use of these warranty disclaimers is largely up to the agency. If the contract's specifications or scope/statement of work adequately define the State's requirements, then there may be no reason to retain implied warranties. Except for the implied warranties of infringement/title, these disclaimers are often included in State contracts.

3. The problem with the third paragraph is its breadth. Vendors often want limitation of liability clauses in their contracts for two reasons. First, the clauses limit the amount of damages to "direct" damages, that is, the actual damages that the buyer can prove that relate directly to the value of the supply or service provided. Second, these clauses commonly try to limit the amount of damages to a fixed amount or some percentage of the contract value.

If a contractor breaches its contract, under the law the State is entitled to direct, consequential, and incidental damages. Direct damages in contract termination situations can be described as the "loss of the benefit of the bargain," that is, what more will the State now have to pay to get acceptable performance comparable to what the delinquent contractor promised? In a less serious breach, the damages are usually, "how much less is the performance worth in the manner in which is performed?" Other than in transactions in goods governed by the UCC, there is no common definition for the other types of damages. Applying the UCC definitions, though, this particular limitation of liability clause eliminates claims for: expenses reasonably incurred, e.g. inspection and receipt, incident to the breach (incidental damages); and other losses of which the vendor had reason to know at the time of contracting, including injury to person or property resulting from the breach (consequential damages, e.g. productivity costs). Bottomline: know what categories of damages you are excluding.

"Special" damages generally are any damages that would not be the usual and natural consequence of any wrongful act. "Punitive" damages may be recoverable in lawsuits involving personal injury or damage to property. The overt exclusion of these damages highlights the other problem with the clause: its apparent applicability to bodily injury and property damage claims. Vendors have good reasons to limit liability for economic losses indirectly caused by defective performance. Otherwise, a software vendor supplying $500 accounting software could be faced with claims in the thousands of dollars where a buyer experienced productivity damages after the software somehow failed. The negotiation of that kind of economic loss limitation is within the discretion of the agency. But with respect to possible claims based on bodily injury or property damage claims arising out of contractor performance, these types of damage limitation provisions should not govern. Deleting the reference to "tort" actions and special and punitive damages is one way to limit the scope to economic type damages.

The last sentence of the clause limits the amount to "actual payments." In service and license agreements, however, where periodic (e.g. monthly) payments are being made, early payments can be quite small. If the contractor defaulted early in performance, this clause would severely limit the damages. Consequently, we recommend that the limitation of liability clause be revised to refer to the price or contract amount, rather that actual payments.

Page 6-28 and clause B-12 of the *Colorado Contract Procedures and Management Manual* have model language that can be adapted to suitably restrict these limitation of liability clauses consistent with State policy, making damage limitations inapplicable to claims based on bodily injury and damage to tangible property. You should also consider whether the limitation of liability clause unreasonably limits State remedies where there are third party claims of infringement.

These provisions are sometimes difficult to spot in a contract. And they are often difficult to tailor to make them acceptable. Unless you are experienced in contracting, we suggest that you get the help of your agency's assistant attorney general when trying to negotiate these provisions with vendors.

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CCIT MEMBERS NOTE

Please note that our meeting will be held in Suite 1450 of the Chancery Building, located in Denver at 1120 Lincoln Street. This is due to the number of members attending our quarterly meetings.

On the World Wide Web at :

www.state.co.us/gov_dir/gss/acc/

CONTRACT PROCEDURES AND MANAGEMENT MANUAL
contract/contract.htm

PRIVATIZATION PROGRAM PROCEDURES AND FORMS
private/private.htm

CURE

CCIT Meeting

Wednesday July 15, 1998

Chancery Building, Suite 1450, 1120 Lincoln St.

Agenda

9:00-9:15	Training Update	John Ivy
9:15-9:30	Privatization Program Update	Yvonne Anderson
9:30-10:00	Limitation of Liability	Richard Pennington
10:00-10:20	Break	
10:20-10:45	Leasing Tips	Michael Frieman
10:45-11:15	Real Estate Program	Gary Newell
11:15-11:30	*Draft* Estoppel Policy	Phil Holtmann